

1 Q. Please State your name for the record.

2 A. Donald Coates.

3 Q. Have you previously testified in this matter?

4 A. Yes, I have.

5 Q. What is the purpose of your surrebuttal testimony?

6 A. I am responding to the rebuttal testimony filed by company witnesses:

7 Mr. Wright, Mr. Marsh and Ms. Walker.

8 Q. What is your response to Mr. Wright's rebuttal testimony?

9 A. Mr. Wright asserted, "...GridSouth expenses are...retail electric service
10 expenses." The justifications he offers to support this proposition on pages 2 and
11 3 of his rebuttal testimony are based on motivations provided by the Federal
12 Energy Regulatory Commission ("FERC") and SCE&G's ability to sell at market
13 rates in the wholesale power market. The very last sentence of the justification
14 offers that the form of the GridSouth Regional Transmission Organization
15 ("RTO") "...would help preserve control and oversight of this RTO, to the extent
16 possible, within this region and with the South and North Carolina Commissions."
17 There is no further justification for transferring these costs from the FERC
18 wholesale jurisdiction to the retail jurisdiction offered by Mr. Wright. He then
19 argues on page 11 that these expenses are appropriate for deferred cost recovery
20 from retail because "The FERC has specifically allowed the deferral of GridSouth
21 costs for future recovery in its accounting order for GridSouth....". In the
22 wholesale jurisdiction, I would agree that GridSouth should be allowed to defer
23 and recover the costs of forming an RTO. These costs represent future benefits to

1 the wholesale power markets under FERC's jurisdiction. The facts speak for
2 themselves; these are not retail jurisdiction costs and expenses, yet. These costs
3 and expenses were not incurred as a response to any regulatory Orders or
4 directives of the South Carolina Public Service Commission. GridSouth costs and
5 expenses were in response to the wholesale market regulator, the FERC. It is
6 premature to incorporate GridSouth costs into retail rates until the FERC
7 incorporates these costs into allowable wholesale charges. It is always
8 inappropriate to transfer deferred or stranded wholesale costs directly to the retail
9 ratepayers.

10 Q. What is your response to Mr. Marsh's rebuttal testimony?

11 A. I would ask Mr. Marsh why he asserts I have misunderstood "...how pension
12 liabilities and related costs are recognized in the Company's operating results." Is
13 it because I do not agree with the Company's position? My understanding was
14 and is that the Company relies on Financial Accounting Standards Number 87
15 ("FAS-87"). FAS-87 requires six components to be included when recognizing
16 net periodic pension costs. Those six components listed in paragraph 20 of FAS-
17 87 are: "a. Service cost; b. Interest cost; c. Actual return on plan assets, if any; d.
18 Amortization of unrecognized prior service cost, if any; e. Gain or loss (including
19 the effects of changes in assumptions) to the extent recognized (paragraph 34); f.
20 Amortization of the unrecognized net obligation (and loss or cost) or
21 unrecognized net asset (and gain) existing at the date of initial application of this
22 statement (paragraph 77)". Component "c. Actual return on plan assets, if any"
23 is defined in paragraph 23, on page 7 of FAS-87. Paragraph 23 reads, "For a

1 funded plan, the actual return on plan assets shall be determined based on the **fair**
 2 **value** of plan assets at the beginning and the end of the period, adjusted for
 3 contributions and benefit payments.” Further, FAS-87 pronouncements on
 4 “Gains and Losses” beginning at paragraph 29 provide a systematic method of
 5 recognition or amortization for:

- 6 a) Changes in the value of plan assets,
- 7 b) Changes in projected benefit obligations and
- 8 c) Gains or losses resulting from changed assumptions as to future
- 9 earnings.

10 Overall FAS-87 does an excellent job of taking a long-term view of a long-term
 11 obligation. Therefore, based on FAS-87 accounting, I oppose the Company’s
 12 proposed Proforma adjustment. In my opinion, the FAS-87 values for assets,
 13 liabilities and expense/(income) at a standard December 31 year-end would be the
 14 best values to use for rate making. Given the February 6, 2003 deadline for a rate
 15 order in this case it did not seem practical to recommend using the December 31,
 16 2002 values. Thus, we are left with Test Year End as the second most reliable
 17 measure of Pension expense/(income) available. It is possible for the actuaries to
 18 prepare a study at any date using the FAS-87 model. However, the multiple
 19 decision options for values and assumptions used in the input and the improbable
 20 task of independent verification of the actuarial study at some interim date make
 21 the use of “latest data” extremely susceptible to intentional or inadvertent
 22 manipulation. Thus to avoid endless arguments over the date to use for asset
 23 valuation and appropriate discount rates to use in a “latest data” actuarial study

1 for an interim date FAS-87 calculation, I am recommending the use of the Test
2 Year End values without any Proforma adjustment.

3 Q. What is your response to Ms. Walker's rebuttal testimony?

4 A. The cash outlay for fuel comes when the fuel inventory is purchased and is
5 recognized for rate base purposes as inventory. When the inventory is transferred
6 to expenses as it is used up during operations there is no new Cash expenditure.
7 Cash working capital calculated using the 1/8th method is designed to provide rate
8 base treatment for cash required for items not included in rate base according to
9 the original Federal Power Commission order establishing this as the industry
10 standard. The recognition of the fuel inventory in rate base provides full rate of
11 return treatment for SCE&G. Additional return provided by including fuels in the
12 calculation of cash working capital requirements rate base allowance would
13 provide double returns to the company. After reading Ms. Walker's rebuttal
14 testimony I decided to test the reasonableness of my proposal to use \$45,797,000
15 as Cash Working Capital Allowance in Rate Base. To accomplish this I turned to
16 the Sixth Annual, 2002 Working Capital Survey conducted jointly by CFO
17 magazine and REL Consultancy Group as a published source of working capital
18 management statistics. In the survey, CFO magazine reported Cash Conversion
19 Efficiency for SCE&G of 27%. By applying this to Operating Revenues
20 Requested in Exhibit DII of \$1,332,885,000 I extrapolated daily positive cash
21 flow of \$985,970. Multiplying the daily cash flow by the 45 days working
22 capital reported for SCE&G¹ in the survey, I arrived at Cash Working Capital

¹ Selected observations of 'Days Working Capital' from the survey: SCE&G 45 days, Virginia Electric & Power Company 34 days, Florida Power & Light Company 20 days, Florida Power Corp. 33 days, The

1 needs of \$44,368,638. This is only a reasonableness test and should not be
2 substituted for the standard 45-day regulatory calculation.

3 As an aside, I noticed the “days working capital” reported for some other
4 utilities in the Eastern United States indicate SCE&G has an opportunity to
5 improve their cash management methods and reduce their days working capital
6 needed. It is precisely these opportunities that make rate base/rate of return
7 regulation economically efficient. Under effective utility regulation, such as that
8 practiced here in South Carolina, the utility company is given rates sufficient to
9 provide such opportunities. Then it is up to Company management to make the
10 most of those opportunities instead of asking that an elegant method of balancing
11 monopoly power be turned into cost plus recovery.

12 Q. Does this conclude your surrebuttal testimony?

13 A. Yes, it does.